

Testimony of Mr. Frederick W. Smith,
Chairman, President and CEO, FedEx Corporation
before the U.S. Senate Committee on Small Business and Entrepreneurship
Hearing on "The Impact of Rising Gas Prices on America's Small Businesses"
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I thank Chairman Kerry and the entire Committee for this opportunity to testify about the impact of rising gas prices on America's small businesses. Some in the audience may be asking why the leader of one of the seventy largest companies in America is speaking before a body that is charged with advancing the interests of small businesses and entrepreneurs. Well, in my opinion, the reasons are numerous and compelling, and I welcome the chance to explain them.

First, and by no means least important, is the fact that FedEx started as a small business within the lifetimes of most of the people in this room. Since its founding in 1971, FedEx has expanded tremendously, but our corporate culture remains centered on the same commitment to customer satisfaction that enabled our rapid growth. I believe this attention to the needs of the customer is shared by most small business owners and entrepreneurs.

Second, FedEx's value proposition is to build networks that connect businesses of all sizes in all parts of the world. For FedEx, small-business customers are not an after-thought; on the contrary, without an economy that thrives on decentralized initiative, FedEx could not have achieved its current success.

Third and finally, I am here because I recognize that small businesses are severely threatened by the severity of our nation's oil dependence, above all because of our transportation system's overwhelming reliance on gasoline and other oil-based fuels.

I speak to you today on behalf of the Energy Security Leadership Council (ESLC), a non-partisan organization that is working to reduce U.S. oil dependence. I co-Chair the Council along with General P.X. Kelley (Ret.), the 28th Commandant of the United States Marine Corps. We are joined in this effort by a group of distinguished business leaders and retired senior military officers that includes: Admiral Dennis Blair, USN (Ret.), Former Commander-in-Chief, U.S. Pacific Command; Admiral Vern Clark, USN (Ret.), Former Chief of Naval Operations; Michael L. Eskew, Chairman and CEO, UPS, Inc.; Adam M. Goldstein, President, Royal Caribbean International; General John A. Gordon, USAF (Ret.), Former Homeland Security Advisor to the President; Maurice R. Greenberg, Chairman and CEO, C.V. Starr & Company, Inc.; Michael Jackson, Chairman and CEO, AutoNation, Inc.; Admiral Gregory G. Johnson, USN (Ret.), Former Commander, U.S. Naval Forces, Europe; Robert D. Hormats, Vice Chairman, Goldman Sachs (International); Herbert D. Kelleher, Executive Chairman, Southwest Airlines Co.; John F. Lehman, Former U.S. Secretary of the Navy (1981 – 1987); Andrew N. Liveris, Chairman and CEO, The Dow Chemical Company; General Michael E. Ryan, USAF (Ret.), 16th Chief of Staff, U.S. Air Force; Jeffrey C. Sprecher, Chairman & CEO, IntercontinentalExchange | ICE; David P. Steiner, CEO, Waste Management, Inc.; and General Charles F. Wald, USAF (Ret.), Former Deputy Commander, U.S. European Command. Together, we are convinced that government must confront the economic and

national security risks that flow from our excessive reliance on oil, much of which is located in unstable and unfriendly parts of the world.

Oil is the life-blood of our economy. In the U.S., we consume more than 20 million barrels of oil per day (mbd), a quarter of the world total. More than 60 percent of the oil we do use is imported. And nearly 70 percent of our oil consumption goes toward transportation, which relies on oil for 97 percent of delivered energy with almost no substitutes available. According to *Oil Shockwave*, an oil crisis simulation conducted in 2005, a mere 4 percent shortfall in global daily oil supplies could push the price of oil to more than \$120 per barrel. That equates to gasoline prices of around \$4.70 per gallon.¹ In the event of such a crisis, transportation would be sharply impacted, and this would in turn damage all economic sectors.

The global oil system is incredibly fragile. It is susceptible to politics, war, and terrorism. To grasp the danger, just look at the threats to shipping. Most oil shipments have to pass through a handful of maritime chokepoints. Roughly 80% of Middle East oil exports pass through the Strait of Hormuz (17 mbd), Bab el Mandeb (3 mbd), or the Suez Canal/Sumed Pipeline (3.8 mbd). Another 11.7 mbd pass through the Strait of Malacca and 3.1 mbd through the Turkish Straits. All of these passageways are vulnerable, and threats are proven; indeed, in October 2002, the French supertanker *Limburg* was rammed off the coast of Yemen by a small boat packed with explosives in an Al-Qaeda linked attack. Since alternative routes are lacking, the effect of a major blockage at one of these points could be devastating. Even unsuccessful attacks on tankers are likely to raise insurance rates and thus oil prices.

Small businesses would bear a particular heavy burden during an oil supply crisis. According to the National Small Business Poll on Energy Consumption conducted in 2006 by the National Federation of Independent Business (NFIB), 10 percent of small businesses claim that energy is their biggest cost, and another 25 percent claim that energy is one of their two or three largest business expenses.² Thirty-eight percent report that their primary energy costs are attributable to vehicles.

Clearly, many of America's small businesses are engaged in one way or another in the transportation business. This alone would make them highly vulnerable to increases in the price of gasoline and diesel fuel. But the situation is even more precarious because small businesses generally have less pricing power and, thus, a harder time passing along energy costs to consumers; as such, their margins are bound to come under pressure when fuel prices rise. And small businesses are boxed in even more tightly by capital constraints that would make it difficult for them to rapidly replace standing vehicle fleets with more fuel-efficient versions.

Small businesses and entrepreneurs are the backbone of the free-market economy that holds great promise for hardworking men and women from all walks of life. But the

¹ *Oil Shockwave* (2005), an oil crisis executive simulation conducted by the National Commission on Energy Policy (NCEP) and Securing America's Future Energy (SAFE).

² NFIB, *National Small Business Poll*, 6, no. 3 (2006).

American people must recognize that the twenty-first century global oil market is well removed from the free-market ideal. By some estimates as much as 90 percent of all oil and natural gas reserves are held by national oil companies (NOCs) that are either partially or fully controlled by governments. Oil markets are not only politicized, they are also distorted by the presence of large economic externalities, such as military expenditures, that are not factored into the retail price of consumer fuels.

Given these realities, we must accept that market forces alone will not solve our oil problems. Instead, government must step in to spur and, in some cases, require private-sector responses. This is not a decision I came to easily. As an entrepreneur myself, I am not one to encourage regulation where other effective solutions are available. But the fact is the global supply of oil is determined by a group of men who gather together and collude in ways that would be considered illegal in the U.S. To combat such anti-competitive practices, government intervention is not merely desirable—it is essential.

In December of last year, the Energy Security Leadership Council unveiled a set of *Recommendations to the Nation on Reducing U.S. Oil Dependence*. This report calls on government to provide a comprehensive plan for energy security for our country; the Council is convinced that this policy must include strengthened vehicle fuel-economy standards for all cars and trucks, increased domestic oil production in conjunction with expanded environmental protections, greater availability of renewable fuels, and improved international arrangements to secure the global oil supply.

To minimize oil dependence and its associated national security risks, both political parties must discard the dogmatic approaches that have hampered the pursuit of energy security for decades. Democrats must recognize that the failure to press forward with the environmentally responsible development of domestic energy resources exacerbates the dangers of oil dependence. Refusing to develop secure sources of domestic production leads to an unnecessary over-reliance on imported oil. Aside from amplifying the potential risk of a supply interruption, the preference for imported oil unnecessarily transfers hundreds of billions of dollars of the nation's wealth to foreign lands.

For their part, Republicans must accept that the free market has not—and will not—adequately motivate the investments necessary to protect the nation in the event of an oil crisis. As such, mandating improvements in the fuel economy of our cars and trucks is one critical and unavoidable step that Americans must take if we are to halt our national descent into unmitigated oil dependence.

During the last few months, the Council has collaborated with numerous Senators from both parties to develop legislation in keeping with our *Recommendations*. In recent weeks, the Senate has made great strides in this regard, in particular though bipartisan support for dramatically improved vehicle fuel-economy standards. As reported by the Committee on Commerce, Science and Transportation, the “Ten-in-Ten Fuel Economy Act” sets workable standards for the fuel economy of new cars and light trucks with a requirement for fleet fuel economy to reach 35 mpg by model year 2020. Beginning in 2021, the fleet-wide average fuel economy of cars and light trucks would be required to increase 4 percent year over year. The National Highway Traffic Safety Administration

(NHTSA) would have the discretion to require different percentage increases for the different classes of vehicles in pursuit of the prescribed fuel-economy improvement for the entire new vehicle fleet.

Furthermore, “Ten-in-Ten” will set fuel-economy standards for medium and heavy trucks, classes of vehicles that have not previously been subject to mileage requirements, even though they account for as much as 10 percent of U.S oil demand.

This new approach to fuel economy is very different from the Corporate Average Fuel Economy (CAFE) system now in place. Whereas all automakers currently have to meet the same corporate average fuel-economy number, the new system will present each manufacturer with a unique standard tailored to its unique production palette. This will be possible because fuel-economy standards will be formulated for specific vehicles grouped into classes by attributes. This focus on attributes will also ensure that Americans will still be able to purchase different types of vehicles that cater to different transportation needs. Critically, this new system will remove the safety-compromising incentive to down-size and down-weight vehicles, since the mileage attainments of highly efficient smaller vehicles will no longer be averaged with those of less-efficient large ones. Flexibility will be further ensured by “off-ramps” that will allow standards to be relaxed in a given year if they are not cost-effective. The bill will ensure that the standard in any year is the maximum that is safe, technologically feasible, and economically beneficial to our country.

This is truly path-breaking legislation that merits broad support. If paired with complementary measures to diversify our transportation fuel supply and to safely increase domestic oil and natural gas production, it will constitute a viable strategic plan for heightened energy security.

Without an expanded supply of alternatives, conventional petroleum will continue to power nearly all of our motor transport. Such reliance on a single non-substitutable input creates profound economic dangers. For instance, OPEC could slash investment in oil exploration and production to keep oil prices high over the long term, and we would have little option but to pay those prices. Even as we cut our demand, OPEC might continue to perversely cut production in order to maintain exorbitant prices. Only viable substitutes could free us this nightmare scenario.

Corn-based ethanol is by far the most viable domestic alternative transportation fuel. At a maximum, however, corn-based ethanol may be able to displace 10% of our gasoline use before corn demand outstrips supply. Corn ethanol will undoubtedly remain an important alternative fuel, but we must also develop newer technologies that have the potential to loosen the constraint posed by limited corn supplies.

Cellulosic ethanol is one of the most promising emerging biofuels, and the Council has put forth policies for fostering the growth of this industry. In addition, we have proposed plans for growing the demand-side of the biofuels market, in particular through incentives that will aid in the development of critical delivery infrastructure. Finally, we

propose a system of variable subsidies that will safeguard taxpayer dollars by reducing government payments to the ethanol industry when oil prices are high and ethanol production is correspondingly profitable. If oil prices do fall, perhaps through cartel actions, the subsidies would rise again to protect the biofuels industry as a strategic bastion of supply diversification. Our plan will also offer additional protections to biofuels production facilities that have not paid off their capital costs, especially if they employ emerging technologies.

Biofuels are part of the solution, but we should not fool ourselves into thinking that America can “grow” its way out of this problem. America’s fuel needs cannot be met with biofuels alone. Even Brazil, which has roughly the same land mass as the continental U.S. but whose fuel requirements are only a small fraction of ours, still relies on oil for most of its transportation energy. The U.S. will continue to require oil for the foreseeable future.

The U.S. plays a critical role in global petroleum production. Currently the third largest oil producer in the world after Saudi Arabia and Russia, America has produced more total oil than any other nation. Nevertheless, the U.S. is the world’s largest consumer by far, accounting for 25% of the world's daily oil consumption while providing only around 10% of supply. Much of America’s untapped resources are legally off limits to production. These production “moratoria” are often justified on environmental grounds, even though the oil production industry has amassed an excellent environmental record. From 1985 to 2001, U.S. offshore operators produced 7 billion barrels of oil with a spill rate of only .001%. More recently, 3,050 of the Gulf’s 4,000 platforms and 22,000 miles of Gulf pipelines were in the direct path of either Hurricane Katrina or Hurricane Rita. Despite the destruction of 115 platforms, damage to 52 other platforms and 535 pipeline segments, and the near total shut-down of the Gulf’s offshore oil and gas production, there were no major oil spills attributed to either storm.

The Council believes it is sensible to increase access to exploration and production on the Outer Continental Shelf (OCS) as long as government and the oil and gas industry are willing to reasonably strengthen the legal and financial penalties that can be imposed in the event of any damage to the environment. To be sure, increased U.S. production on the OCS will not fundamentally shift the global distribution of oil resources, the majority of which will remain in the Middle East and under OPEC control. But by boosting production domestically, the U.S. can improve the flexibility and resiliency of the global oil market, especially in an increasingly tight market where spare production capacity is concentrated in a handful of countries.

Rising worldwide demand, increasing levels of international conflict, and limited excess oil production capacity are all combining to increase the probability that we will face a severe oil crisis. I would argue that oil dependence is the most important security issue facing the nation today with the possible exception of weapons of mass destruction. But there is no mystery regarding the steps that can be taken to protect the American people. By strengthening fuel-economy standards, facilitating the development of diversified fuel sources, and expanding stable domestic production, America’s leaders can dramatically

boost our economic and national security, but they do not have the luxury of delaying these decisions far into the future. The choices must be made now, and in fact these decisions are confronting the Senate this week. I trust that the Senate will send a clear signal in favor of improved energy security. This would be the best news our small businesses and entrepreneurs could receive.